

**Multistate Tax Commission
38th Annual Conference
Boise, Idaho; July 28, 2005**

A Comprehensive and Sensible UDITPA

Charles E. McLure, Jr.*
Hoover Institution
Stanford University

Outline

- I. State laws need to be Uniform and Sensible.
 - Thus the need for UDITPA
 - UDITPA needs to be Comprehensive, if it is to be Sensible
 - States need actually to adopt and implement UDITPA
- II. Four obstacles to implementing a Comprehensive and Sensible UDITPA
 - Constitutional limitations
 - In theory these could be overcome by federal legislation, but...
 - Congressional limitations
 - Congress cannot be trusted not to make matters worse
 - Historical and on-going initiatives to undermine sensible policy
 - Unreasonable limitations on nexus for business activities taxes
 - Internet Tax Freedom Act
 - Inability of states to achieve uniformity
 - No mechanism for achieving and maintaining uniformity, aside from Congressional action
 - Inherent difficulty of some issues: not the chief problem
- III. Division of Income should be *Uniform*
 - To avoid gaps and overlaps in the tax base
 - Nowhere income: the traditional concern of tax administrators
 - Double taxation
 - To avoid non-rate tax competition
 - Not combining unitary businesses (allows tax planning)
 - Manipulating apportionment formulas: shift toward greater weight on sales
- IV. UDITPA should be *Comprehensive*

*Comments are welcome; please send them to mclure@hoover.stanford.edu or to Charles McLure; Hoover Institution; Stanford, CA 94305-6010.

UDITPA should include nexus rules

UDITPA should include unitary combination

Otherwise nowhere income and tax competition are likely

Overtaxation may occur

V. The uniform system should be *Sensible*

A. Nexus standards

Nexus rules and apportionment rules should be consistent

Nuttiness of P.L. 86-272 and sales only apportionment

Sales where no nexus; nexus where few sales

Aggravated by lack of unitary combination

Writing on a clean slate (may be irrelevant, as long as PL 86-272 exists)

Nexus geared to non diminimis existence of apportionment factors

Given PL 86-272 — or an even more restrictive rule

No good answer

Illustrates problem of Congressional interference

Does it make sense to eliminate sales from the formula?

The nonsense of *Geoffrey* nexus

Intangibles have no situs

Unnecessary in a world of combination.

B. The apportionment formula

Apportionment should reflect where income is earned

An economic issue, not a constitutional one

Three-factor formula probably does fairly well, whether or not sales are double-weighted

Sales-only apportionment does not reflect where income is earned

Any weight on sales greater than 50 percent it too much

C. The Property factor

Treatment of intangible property is the toughest UDITPA problem

Necessary to distinguish two types of intangible property

Financial assets should be excluded from the property factor

Intangible intellectual property constitutes the “crown jewels” of many modern corporations (Software, patents (e.g., pharmaceuticals), know-how)

Exclusion is clearly not appropriate

But intangible assets have no situs

Valuation may be difficult

D. The Sales factor

Sales other than of tangible property

Extremely important in the modern economy

Existing UDITPA rule makes no sense

Should be based on destination of sales

Exclusion of sales of financial assets

Definitional issues

Throwback vs. Throwout

Throwback has no logical appeal

Lack of throwback can be used as a competitive tool

Throwout prevents nowhere income

E. Other issues

Business/non-business income

Ignoring constitutional constraints: apportion all income

Simplicity vs. perfection

Given constitutional constraints: non-business income is income that cannot constitutionally be apportioned (Walter Hellerstein)

Need for uniform regulations and interpretations thereof

Dividends should be exempt

Needed to avoid double-taxation

There is no clearly correct way to allocate them

VI. Administering uniformity

Going beyond MTC

A specialized judiciary dealing only with state tax issues

Selected references

Hellerstein, Walter, and Charles E. McLure, Jr., "Congressional Intervention in State Taxation: A Normative Analysis of Three Proposals," *State Tax Notes*, Vol. 31, No. 9 (March 1, 2004), pp. 721-35.

McLure, Charles E., Jr., "The Nuttiness of State and Local Taxes -- and the Nuttiness of Responses Thereto," *State Tax Notes*, Vol. 25, No. 12 (September 16, 2002), pp. 841-856.

McLure, Charles E., Jr., "Understanding The Nuttiness of State Tax Policy: When States Have Both Too Much Sovereignty and Not Enough," Luncheon Address to the National Tax Association, Washington, May 20, 2005, available at ntanet.org/.